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No. 90-530

In The

Supreme Court of the United States

October Term, 1990

ROUND TABLE PIZZA, INC., et al.,

Petitioners,

vs.

WILLIAM R. LARSON,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

Should this Court grant review to consider whether a single court of appeals panel misanalyzed the record and based its decision on an allegedly incorrect factual ground although the legal grounds were correct? While petitioner complains that the Court of Appeals misapplied the abuse of discretion standard of review, there is no dispute over the propriety of the standard the Court stated it was applying. Rather, petitioner complains only that the Court applied the correct standard in an incorrect way in this particular case.

LIST OF PARTIES

The parties to the proceedings below were Richard A. Dumke, Scott O. Bergren, Norman E. Dean, Frederick L. Doar, Paul J. Miller, Robert C. Scheidemann, Charles A. McPhee, Jr., Anne W. Barron, George P. Kailis, Round Table Pizza, Inc., a California corporation, Hills Bros. Coffee, Inc., a Delaware corporation, Aussie's Enterprises, Inc., dba Bonza Tucker, a California corporation, and respondent William R. Larson.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

LIST OF PARTIES ii

OPINIONS BELOW 1

JURISDICTION 2

STATUTE INVOLVED 2

STATEMENT OF THE CASE 5

ARGUMENT 12

A. The Court of Appeals Properly Held That A Single Shareholder In Mr. Larson's Position May Maintain A Derivative Action 12

B. Round Table's Claim That This Court's Certiorari Jurisdiction Is "Mandated" Does Not Withstand Analysis 17

1. The Court of Appeals Correctly Applied The Abuse Of Discretion Standard 18

2. The Court of Appeals' Decision Was Not A "Departure," Much Less A "Far Departure" From Accepted Judicial Decisions 24

CONCLUSION 25

TABLE OF AUTHORITIES

Page

CASES

Anderson v. Bessemer City, 470 U.S. 564 (1985) 19

Baron v. Strawbridge & Clothier, 646 F.Supp. 690 (E.D. Pa. 1986) 14

Cohen v. Beneficial Industrial Loan Corp., 331 U.S. 541 (1949) 12

Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984) 13

Davis v. Comed, Inc., 619 F.2d 588 (6th Cir. 1980) 14, 15, 25

De La Cruz v. Tormey, 582 F.2d 45 (9th Cir. 1978), cert. denied, 441 U.S. 965 (1979) 5

Dollar Rent A Car of Washington v. Travelers Indem., 774 F.2d 1371 (9th Cir. 1985)..... 19, 20, 21

Edinburgh Assur. Co. v. R.L. Burns Corp., 669 F.2d 1259 (9th Cir. 1982)..... 19

F.D.I.C. v. Kerr, 650 F.Supp. 1356 (W.D.N.C. 1986) 16

FSLIC v. Sahni, 868 F.2d 1096 (9th Cir. 1989).....19, 20

Fradkin v. Ernst, 98 F.R.D. 478 (N.D. Ohio 1983) 14

G.A. Enterprises, Inc. v. Leisure Living Commun., Inc., 517 F.2d 24 (1st Cir. 1975) 14

Gaines v. Haughton, 645 F.2d 761 (9th Cir. 1981), cert. denied, 454 U.S. 1145 (1982) 5

Halsted Video, Inc. v. Guttillo, 115 F.R.D. 177 (N.D. Ill. 1987) 15

Heat and Control, Inc. v. Hester Industries, Inc., 785 F.2d 1017 (Fed. Cir. 1986)..... 20

Hornreich v. Plant Industries, Inc., 535 F.2d 550 (9th Cir. 1976)..... 18

TABLE OF AUTHORITIES – Continued

Page

Jones v. H. F. Ahmanson & Co., 1 Cal.3d 93 (1969) 23

Kern v. TXO Production Corp., 738 F.2d 968 (8th Cir. 1984) 20

Koster v. Lumbermens Mutual Cas. Co., 330 U.S. 518 (1947) 12

Kuzmickey v. Dunmore Corp., 420 F.Supp. 226 (E.D. Pa. 1976) 16

Larson v. Dumke, 900 F.2d 1363 (9th Cir. 1990) 1, 10, 11, 12

Lewis v. Curtis, 671 F.2d 779 (3d Cir.), cert. denied, 459 U.S. 880 (1982) 15, 18, 20

Matter of Beverly Hills Bancorp, 649 F.2d 1329 (9th Cir. 1981) 19, 24

Ohio-Sealy Mattress Mfg. Co. v. Kaplan, 90 F.R.D. 21 (N.D. Ill. 1980) 15

Owen v. Modern Diversified Industries, Inc., 643 F.2d 441 (6th Cir. 1981) 18, 19

Robinson v. Computer Servicenters, Inc., 75 F.R.D. 637 (N.D. Ala. 1976) 14

Rogers v. American Can Company, 305 F.2d 297 (3d Cir. 1962) 5

Ross v. Bernhard, 396 U.S. 531 (1970) 13

Ross v. Moffitt, 417 U.S. 600 (1974) 18

Rothenberg v. Security Management Co., Inc., 667 F.2d 958 (11th Cir. 1982) 19

Shulman v. Ritzenberg, 47 F.R.D. 202 (D.D.C. 1969) 15

Surowitz v. Hilton Hotels Corp., 383 U.S. 363 (1966) 15

TABLE OF AUTHORITIES – Continued

Page

Sweet v. Bermingham, 65 F.R.D. 551 (S.D.N.Y. 1975) 13, 14

United States v. United States Gypsum Co., 333 U.S. 364 (1948) 19

STATUTES AND RULES

Fed. R. Civ. P. 23.1 ..... *passim*

Fed. R. Civ. P. 54(b) 2

Supreme Court Rule 10.1 ..... 17, 18, 24

28 U.S.C. Section 1331 2

28 U.S.C. Section 1254(1) 2

TEXTS

Cohn, "The New Federal Rules of Civil Procedure," 54 *Geo. L.J.* 1204 (1966) 13

2 Marsh's Calif. Corporation Law § 14.28 (1988 Supp.) 13

3B Moore & J. Kennedy, *Moore's Federal Practice*, ¶ 23.1.16[3] (2d ed. 1979) 15

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OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit is reported at 900 F.2d 1363 and is reprinted in Appendix I of petitioner's petition. (A-1-31) The memorandum decisions and orders of the United States District Court for the Northern District of California (CR 291 & 344) have not been reported. They are reprinted in Appendices II and III of petitioner's petition. (A-40-51)

JURISDICTION

The district court had subject matter jurisdiction pursuant to 28 U.S.C. Section 1331, and dismissed Mr. Larson's derivative claims, ruling that he did not fairly and adequately represent similarly situated shareholders under Fed. R. Civ. P. 23.1 (hereafter Rule 23.1 or the Rule). The district court certified the matter for appeal under Fed. R. Civ. P. 54(b), and Mr. Larson filed a timely appeal with the Ninth Circuit. On April 9, 1990, that Court reversed the judgment of dismissal and reinstated the derivative claims. Round Table filed a petition for rehearing and rehearing *en banc* on April 24, 1990, which was denied on June 25, 1990. (A-52-53) Round Table filed a timely petition for writ of certiorari on September 24, 1990, and invokes this Court's jurisdiction under 28 U.S.C. Section 1254(1).

STATUTE INVOLVED

The statute involved is Federal Rule of Civil Procedure 23.1, which provides in pertinent part:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to

> confer jurisdiction on a court of the United States which it would not otherwise have. . . . The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association . . . . (*See*, Petn. at A-54-55 for complete text of Rule 23.1)

REASONS FOR DENYING THE WRIT

The Court of Appeals held that a single, substantial shareholder like Mr. Larson may pursue the derivative claims on behalf of the corporation, notwithstanding opposition to the lawsuit by the non-defendant shareholders. The Court reasoned that because those shareholders believed they stood to lose financially from the lawsuit, Mr. Larson was not "similarly situated" to them. It also held that Mr. Larson met the "fair and adequate representation" requirement of Rule 23.1 and that he was not disqualified from serving as a proper derivative plaintiff because of any "economic antagonism."

The effect of the Court of Appeals' opinion is to give Mr. Larson his day in court, by granting him standing to pursue the derivative claims against the errant directors and officers for their egregious misconduct over the past decade. Not only is that result consistent with the judicial policy that cases should be disposed of on their merits, but the Court's opinion represents a correct application of the principles governing "adequacy of representation" issues under Rule 23.1.

Nevertheless, Round Table, a nominal defendant that is controlled by the very individuals who are alleged to have engaged in wrongdoing, has decided to pursue the matter in this Court, asserting that the Court is "mandated" to exercise certiorari jurisdiction. Its petition proceeds from three erroneous or misleading premises:

> First, it assumes that this Court's supervisory powers should be exercised to correct an asserted error of a Court of Appeals panel when that error is at most based only on a misreading of the facts in the record which are unique to this case and have no application to other cases.
>
> Second, it assumes that this Court should grant certiorari to correct a Court of Appeals' alleged misapplication of the "abuse of discretion" standard of review, when the Court's opinion, if fairly read, demonstrates that the Court fully understood that standard, gave deference to the district court where appropriate, and properly reversed for *both* an error of law and a "clearly erroneous" factual finding.
>
> Finally, it contends that certiorari should be granted because the Court of Appeals' analysis was wrong on two issues, but nowhere does it challenge – indeed, it does not even mention – that there was a third aspect to the Court's opinion that is unquestionably a valid basis for its holding under governing legal principles.

Once these three misperceptions are corrected and the Court of Appeals' opinion fairly analyzed, it is apparent that there is no reason for adding this case to an already overburdened Supreme Court docket.

STATEMENT OF THE CASE

William R. Larson is the founder of Round Table Pizza. In 1978, he sold a 75 percent interest in the company to Richard Dumke and his associates ("the Dumke group"). For approximately ten years following the sale, the Dumke group repeatedly placed their personal and financial interests above Round Table's, and engaged in speculative business ventures and self-interested transactions that deprived the company of millions of dollars. (CR 149 at ¶¶ 29-31, 91)[1] The Dumke group also: (1) consistently misrepresented important facts and concealed information from shareholders, other directors, and financial institutions; (2) withheld information from Mr. Larson and his representatives by denying them access to corporate records and removing documents from files to which he was given access; and (3) forged records to cover up their acts. (CR 149 at ¶ 88)

Specifically, the Dumke group:

> – Secretly profited by causing Round Table to acquire Far West Pizza, Inc., a financially strapped pizza company which the Dumke group owned, through an exchange of Round Table shares for Far West shares, by grossly inflating the value of Far West stock, concealing the nature and extent of Far West's liabilities,

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[1] The facts recited here are taken from the allegations of the First Amended Complaint (CR 149), which, at this preliminary point in the litigation and for purposes of finally determining the motion to dismiss, must be deemed true. *Gaines v. Haughton*, 645 F.2d 761, 770 (9th Cir. 1981), *cert. denied*, 454 U.S. 1145 (1982), *citing*, *De La Cruz v. Tormey*, 582 F.2d 45, 48 (9th Cir. 1978), *cert. denied*, 441 U.S. 965 (1979); *Rogers v. American Can Company*, 305 F.2d 297, 318 (3d Cir. 1962)

and misrepresenting Far West's profitability. (CR 149 at ¶¶ 58-60, CR 263 at 13, n. 11);

– Secretly benefitted by manipulating the acquisition of Aussie's, a chicken restaurant franchise, such that (1) Round Table paid for a purported 50 percent control of the company but received only 42 percent, with the remaining 8 percent going to Dumke group member Scott Bergren, (2) Round Table was forced to guarantee 100 percent of an Aussie's debt despite its minority interest in the company; (3) additional stock was issued to Dumke group members after the initial offering, thereby diluting Round Table's interest to below 10 percent, and (4) when Aussie's proved to be a bad investment, caused Round Table to purchase back the Dumke group members' stock at the original selling price (despite its substantial decrease in value), all to Round Table's severe prejudice (CR 149 at ¶¶ 62-77, 95-98, 107-108);

– Usurped Round Table's corporate opportunity in acquiring Buffalo Chips, a gourmet potato chip company, by secretly acquiring the company, then rescinding the acquisition a few months later for a better investment opportunity and embroiling Round Table in costly litigation when Buffalo Chips sued the Dumke group and Round Table concerning the rescission (CR 149 at ¶¶ 39-55, 105); and

– Induced Round Table to establish, through misrepresentations and inaccuracies as to the company's expected performance and worth, an Employee Stock Option Plan that overburdened the company with debt and loan obligations that it could ill afford, all for the purpose of paying themselves nearly $9 million (CR 149 at ¶¶ 33-38, CR 105, Exhs. A-C, F-H).

As a result of the foregoing conduct and other wrongful action by which the Dumke group profited (CR 149 at ¶¶ 29, 88-92), in the approximately ten years following the sale, Round Table did not experience anywhere near the $6 million to $8 million profit expected of a successful franchise operation of this size, and paid no dividends to its shareholders. (*Id.* at ¶¶ 29-30, 91)

Faced with these improprieties, Mr. Larson brought suit in 1987 against the Dumke group and others, alleging both derivative and individual claims based on violations of federal and state securities laws, RICO, fraud, breach of fiduciary duty, and other common law theories. (CR 1)[2] Before any substantial discovery could be conducted, however, defendants moved to dismiss the derivative counts on the ground that Mr. Larson was an inadequate representative under Rule 23.1, and argued that he could not fairly represent the interests of other "similarly situated" (*i.e.*, "minority") shareholders, who collectively hold only 9.3 of the outstanding stock (or approximately one-third of what Mr. Larson owns individually). (CR 217-234, 245, 255)[3]

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[2] Round Table's claim that "[t]he ESOP transaction was at the center of Larson's motivation for bringing this action" (Petn. at 13) is incorrect. (*See*, Reply Brief of Mr. Larson at 2-3)

[3] In fact, the shareholders who are not associated with the Dumke group represent an even smaller portion of the outstanding stock. As the Court of Appeals observed, of the stock owned by individual non-defendants other than Mr. Larson, Thomas Toldrian, Round Table's Chief Financial Officer and a director at the time of the alleged wrongdoing, owns 7.7 percent and the remaining shareholders hold only 1.6 percent. (A-26)

In support of their dismissal motion, defendants submitted declarations they had prepared on behalf of these shareholders following meetings with them. (*See*, CR 321, Exh. E at 46:7-10, 47:2-4) The declarations alleged, in generally identical boilerplate paragraphs, that these shareholders opposed the lawsuit and supported current management. (*E.g.*, CR 221 at 3-4, CR 222 at 3-5, CR 223 at 3-4).[4]

The district court agreed with Round Table and dismissed the derivative claims. (CR 291 at 2 (A-35-37), (CR 344 (A-40-47)) It found that in order for a derivative plaintiff to meet the "adequacy of representation" requirement of Rule 23.1, he or she must fairly represent a "class" consisting of the other "minority shareholders" – here, "all minority shareholders as of the time of the formation of the ESOP." (CR 344 at 3-4 (A-44)) Because those shareholders "universally oppose[d]" the lawsuit, the court found, Mr. Larson could not fairly and adequately represent their interests. (*Id.* at 4 (A-44)) The

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[4] One of the shareholders, Gennaro Filice, revealed in his deposition that he really didn't "know anything," had "no knowledge of what's going on," and didn't "want to have anymore [*sic*] knowledge of what's going on" (*id.* at 71:23-25) concerning the lawsuit. He admitted that Round Table's lawyers (who were retained by the defendant wrongdoers) told him that the lawsuit was too expensive for the corporation and would "damage" it. (CR 321, Exh. E at 23:2-4, 65:20-23) Counsel also told him that if there had been any wrongdoing, Mr. Larson's individual claims would "take care" of it without the corporation incurring the expense of a lawsuit. (*Id.* at 50:9-13) However, counsel omitted to tell Mr. Filice that any recovery on the derivative claims would go to Round Table, not Mr. Larson. (*Id.* at 26:15-20)

court further reasoned that there was "economic antagonism" between Mr. Larson and the other minority shareholders because those shareholders would be required to return funds received from the sale of their shares to the ESOP, and "antagonism" between Mr. Larson and the corporation, which the district court found would be "harmed" by the ESOP's rescission. (*Id.* at 4-5 (A-45-46))[5]

On appeal, Mr. Larson argued that the district court had abused its discretion because it *both* misperceived or erroneously resolved factual issues *and* erroneously interpreted the "fair and adequate representation" requirement in Rule 23.1 as a matter of law. A substantial shareholder like Mr. Larson, even though opposed by all of the remaining non-defendant shareholders, may nevertheless be an adequate derivative representative under Rule 23.1. The Rule nowhere requires the derivative plaintiff to be "similarly situated" to any other shareholders, nor does it define "similarly situated" shareholders as the "class" of all "minority shareholders," as the district court had ruled. As long as the plaintiff adequately represents the interests of the *corporation* in whose name he sues derivatively, the "fair and adequate representation" requirement of Rule 23.1 is fulfilled. Finally, even if the Rule requires some harmony of

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[5] The district court rejected defendants' claim that Mr. Larson should have made a demand on the directors to bring suit on behalf of the corporation, and found that a demand would have been "futile in this context, where the allegations are that the director defendants participated in the wrongdoing, and in particular, in self-interested transactions." (CR 291 at 2, CR 286, *see*, CR 186-187, 189, 206-207, 209-214, 247-248)

interest between shareholders who are "similarly situated," here because *all* of the remaining shareholders – defendants and non-defendants alike – benefited from defendants' illegal conduct, Mr. Larson is not "similarly situated" to them and he cannot be deprived of derivative standing on that basis.

The Court of Appeals agreed with many of Mr. Larson's arguments, and found that the district court had abused its discretion in at least three distinct ways:

> A. The Court held that Mr. Larson had not made a "formal" or "meaningful" – *i.e.*, proper – demand for rescission of the ESOP, so his "request for money damages resulting from alleged improprieties in establishment of the ESOP" did not "in and of itself make [him] an inadequate representative." (900 F.2d at 1364, 1367-1368)
>
> B. Relying on well-established authority that "a single shareholder may bring a derivative suit" [*id.* at 1368], the Court held that "lack of support for the derivative suit by nondefendant shareholders" is not a factor sufficient to support the district court's exercise of discretion." While the "degree of support a putative plaintiff receives from other shareholders . . . is a factor that should be considered in determining adequacy of representation," here each "non-defendant shareholder . . . has an economic interest in supporting the current management" and thus, "the lack of support for the derivative suit, in and of itself, does not indicate that Larson is an inadequate representative." (*Id.* at 1368-1369) Accordingly, "Larson is the only shareholder

similarly situated and . . . meets the Rule 23.1 qualifications." (*Id.* at 1369)[6]

C. The Court rejected defendants' claim that Mr. Larson's offer to sell his shares to Round Table at prices ranging between $14.75 and $18.75 per share – in excess of the $9.78 per share price that the ESOP paid – proved that the derivative action was a "strike suit" designed to obtain a premium price for his shares. (*Id.* at 1369) The record demonstrated that the high price offering was Mr. Larson's attempt to free his shares from a right-of-first-refusal requirement that the Dumke defendants caused Round Table to enact. (*See*, CR 319 at 1-3, & Exh. D, CR 320, Exh. B, CR 321 at 2-3 & Exh. A, CR 330 at 16, n. 12)

On the basis of the foregoing, the Court concluded:

"that Larson is the true party in interest, that he is familiar with this litigation, that he has a personal commitment to this action, that the remedy sought can be construed as legitimate for the corporation, that Larson's interest in his personal claims do not outweigh his interest in those asserted on behalf of the corporation, and that notwithstanding the possibility of personal vindictiveness or animosity between Larson and the defendants, it has not been established that

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[6] Unfortunately, Round Table's transcription of the Court of Appeal's opinion contains a significant typographical error. On A-27, it quotes the Court of Appeals as stating: "We have concluded that the lack of support for the derivative suit, in and of itself, does not indicate that Larson is an *adequate* representative." (Emphasis added) In fact, the Court of Appeals' opinion states: "We have concluded that the lack of support for the derivative suit, in and of itself, does not indicate that Larson is an *inadequate* representative." (900 F.2d at 1369, emphasis added)

> Larson is an inadequate representative for the derivative claims." (*Id.* at 1369)

Instead of acknowledging that the second ground ("B" above) was a basis for the Court of Appeal's decision, Round Table pretends it does not exist, and focuses its attack solely on the ESOP rescission and "strike suit" issues. On those issues, it insists that because the Court of Appeals made a "far departure" from the accepted course of judicial proceedings and created a "conflict among the circuits" as to the application of the abuse of discretion review standard in Rule 23.1 cases, this Court is "mandated" to grant certiorari. (Petn. at 27-30) Not only are these claims seriously flawed, but the one aspect of the Court of Appeals' opinion that petitioner carefully avoids, proves that the Court reached the right result for the right reason. Accordingly, the petition should be denied.

ARGUMENT

A. The Court of Appeals Properly Held That A Single Shareholder In Mr. Larson's Position May Maintain A Derivative Action

Derivative suits were developed out of a recognition that the corporate structure accords management "almost uncontrolled discretion in handling other people's money." *Cohen v. Beneficial Industrial Loan Corp.*, 331 U.S. 541, 547 (1949). Because directors are able to amass considerable power and abuse the discretion entrusted to them, the courts have held that equity permits shareholders to act to protect the corporation's interest. *Koster v. Lumbermens Mutual Cas. Co.*, 330 U.S. 518, 552-553

(1947); *see, Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 530 (1984).

The derivative plaintiff in such an action acts as management's conscience, to ensure that the corporation follows prescribed guidelines, adheres to its rules, and refrains from engaging in illegal or self-interested transactions. *See generally*, 2 Marsh's Calif. Corporation Law § 14.28 (1988 Supp.). At the same time, because the derivative plaintiff acts as a "corporate surrogate seeking vindication of a corporate right" [*Sweet v. Bermingham*, 65 F.R.D. 551, 553 (S.D.N.Y. 1975)] and the corporation is bound by the result of the suit [*Ross v. Bernhard*, 396 U.S. 531, 538-539 (1970)], the plaintiff must meet certain requirements before the derivative action can proceed.

The "adequacy of representation" element is one such requirement, and seeks to ensure that *if* the derivative plaintiff purports to speak for other similarly situated shareholders, he or she must fairly and adequately represent their interests in seeking redress on the corporation's behalf. Advis. Comm. on Civil Rules, Comment to Rule 23.1; *see*, Cohn, "The New Federal Rules of Civil Procedure," 54 *Geo. L.J.* 1204, 1227 (1966).[7] This element is

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[7] There are other requirements the derivative plaintiff must meet: (1) the plaintiff must have been a shareholder at the time of the challenged transaction or must have acquired shares of other aggrieved shareholders by operation of law; (2) the action must not be a collusive one to confer jurisdiction on a federal court; (3) the plaintiff must make a demand on the directors as a prerequisite to proceeding with the lawsuit, which demand is excused if it would be futile; and (4) if the action is permitted to proceed, the plaintiff may not dismiss or settle the lawsuit without the approval of the court and notice to the shareholders. Rule 23.1.

embodied in Rule 23.1's requirement that "[t]he derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association."

This requirement applies only when the derivative plaintiff purports to represent the interests of "similarly situated" shareholders.[8] As Professors Moore and Kennedy have noted, the "similarly situated" language of Rule 23.1 "must necessarily refer to a minority or other definable group of shareholders *with interests similar to the*

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[8] Where there are *no* "similarly situated" shareholders, however, a derivative plaintiff may nevertheless be disqualified from maintaining the action where he or she has interests antagonistic to the corporation in enforcing its rights. *See, Sweet v. Bermingham, supra,* 65 F.R.D. at 554; *Fradkin v. Ernst,* 98 F.R.D. 478, 484 (N.D. Ohio 1983). However, only "antagonism" that "goes to the subject matter of the suit" – *i.e.*, that demonstrates that the interests of the corporation will be disregarded if the derivative action is maintained – will deprive a derivative plaintiff of standing. *G.A. Enterprises, Inc. v. Leisure Living Commun., Inc.,* 517 F.2d 24, 27 (1st Cir. 1975). Such "antagonism" is generally exemplified by competing business interests, such as competition between the corporation and an entity in which the plaintiff has a personal interest, or by the plaintiff's interest in personal gain which overshadows any corporate interests sought to be furthered by the derivative suit. *E.g., Robinson v. Computer Servicenters, Inc.,* 75 F.R.D. 637, 641-643 (N.D. Ala. 1976); *Davis v. Comed,* 619 F.2d 588, 594-595 (6th Cir. 1980), *Baron v. Strawbridge & Clothier,* 646 F.Supp. 690, 695-696 (E.D. Pa. 1986). Round Table addresses only one such alleged "antagonism" in its petition, which Mr. Larson discusses *infra,* at pp. 22-24.

plaintiff because otherwise a derivative suit would be logically impossible whenever the interest of the majority of the stockholders coincided with the defendants." 3B Moore & J. Kennedy, *Moore's Federal Practice*, ¶ 23.1.16[3] at 23.1-59 (2d ed. 1979) (fns. omitted, emphasis added). Indeed, the most often quoted opinion on the subject of Rule 23.1 adequacy of representation, *Davis v. Comed, Inc., supra*, 619 F.2d 588, states that among the factors the courts should consider in determining adequacy of representation is "the degree of support plaintiff was receiving from the shareholders *he purported to represent*." *Id.* at 594 (emphasis added).

Accordingly, the courts have properly held that a single shareholder may maintain a derivative action, notwithstanding the support of or opposition by a "class" of other shareholders. *See, Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966) (single shareholder owning 0.06 percent of corporation's shares held to be adequate representative); *Lewis v. Curtis*, 671 F.2d 779, 788-789 (3d Cir.), *cert. denied*, 459 U.S. 880 (1982) (single shareholder owning 100 of 8 million shares held to be adequate representative); *Shulman v. Ritzenberg*, 47 F.R.D. 202, 211 (D.D.C. 1969) (single shareholder opposed by 47 of company's 53 shareholders found adequate representative); *see also, Ohio-Sealy Mattress Mfg. Co. v. Kaplan*, 90 F.R.D. 21, 27 (N.D. Ill. 1980) (permitting derivative action by shareholders owning 0.07 percent of stock, even though opposed by "vast majority of shareholders" who collectively owned 90 percent). Other courts have held that the derivative plaintiff need *not* represent "similarly situated" shareholders in order to maintain the action. *Shulman v. Ritzenberg, supra*, 47 F.R.D. at 211; *Halsted Video,*

Inc. v. Guttillo, 115 F.R.D. 177, 180 (N.D. Ill. 1987); *F.D.I.C. v. Kerr*, 650 F.Supp. 1356, 1358-1359 (W.D.N.C. 1986); *but see, Kuzmickey v. Dunmore Corp.*, 420 F.Supp. 226, 230-231 (E.D. Pa. 1976).

The Court of Appeals properly applied these principles in its opinion here. It concluded that, contrary to the district court (CR 344 at 3 (A-44)), Mr. Larson was not required to represent the interests of the "class" of other minority (*i.e.*, nondefendant) shareholders in order to maintain the derivative claims. (A-24-25) It further held that because each of the other non-defendant shareholders benefited from the ESOP's formation and may have been confused and misled as to the consequences of Mr. Larson's potential success on that claim, their opposition to the lawsuit may have been motivated by "individual interests, rather than the good of the corporation." (A-27) Accordingly, their opposition was not determinative of Mr. Larson's ability to serve as a fair and adequate derivative representative because they were not "similarly situated" to him. (*Id.*) This was the precise issue which divided the parties sharply both in the district court and on appeal.

In its petition here, Round Table meticulously ignores this aspect of the Court of Appeals' opinion. Yet, the Court's analysis of the "single shareholder" issue was an adequate basis for reversing the district court's judgment. It was also indisputably a correct interpretation of the Rule 23.1 fair representation requirement that is fully consistent with existing case law. On this basis alone, then, the Court of Appeals reached the correct result on sound reasoning and there is no reason for this Court to intervene.

B. Round Table's Claim That This Court's Certiorari Jurisdiction Is "Mandated" Does Not Withstand Analysis

Round Table asserts that this Court is "mandated" to grant certiorari because the Court of Appeals (1) failed to apply the abuse of discretion standard properly, "thereby rendering a decision 'in conflict with decision[s]' of all other federal Courts regarding the proper standard of review" of adequacy of representation claims under Rule 23.1, and (2) rendered a decision that represented a "far departure" from the "accepted and usual course of judicial proceedings. . . . " (Petn. at 27-30, 34, *citing*, Supr. Ct. Rule 10.1(a)) These claims do not withstand scrutiny.[9]

Round Table's contention is only that the Court of Appeals misanalyzed the record and reached an aberrant result in a single case on unique facts.[10] This is hardly

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[9] As a preliminary matter, it is manifest that certiorari jurisdiction is never "mandated." Supreme Court Rule 10.1 itself provides that "[a] review on writ of certiorari is not a matter of right, but of judicial discretion," and that the writ will be granted "only when there are special and important reasons therefor." The "reasons" specified in Rule 10.1 – which include a conflict among the circuits and a "far departure" from the "accepted and usual course of judicial proceedings" – are not determinative of this Court's jurisdiction. As Rule 10.1 states, the reasons listed are "neither controlling nor fully measuring the Court's discretion," but merely "indicate the character of reasons that will be considered" in determining whether this Court should grant review. Round Table's claim that this Court must grant certiorari if any of the Rule 10.1 factors are present simply misreads the rule.

[10] This argument, of course, erroneously ignores the Court's "single shareholder" analysis discussed above, that is an alternate and independent basis for permitting Mr. Larson to pursue the merits of the derivative claims.

sufficient, because the correctness of a lower court decision is rarely if ever grounds for granting certiorari. As Justice Rehnquist wrote in *Ross v. Moffitt*, 417 U.S. 600, 616-617 (1974), "[t]his Court's review . . . is discretionary and depends on numerous factors other than the perceived correctness of the judgment we are asked to review." To grant certiorari here and in other like circumstances would effectively convert this Court into one of error rather than one whose role is to ensure consistency among the Courts of Appeal and pass on important federal questions of the day.

Moreover, neither of the two Rule 10.1 reasons on which Round Table relies – a purported misapplication of the abuse of discretion standard of review that allegedly creates an inter-circuit conflict or an asserted "far departure" from the "accepted and usual course of judicial proceedings" on the ESOP rescission issue – is present here. The Court of Appeals correctly applied the abuse of discretion test on both legal and factual matters and reached the proper result on the ESOP rescission issue.

1. The Court of Appeals Correctly Applied The Abuse Of Discretion Standard

All parties here agree that the abuse of discretion standard applies in reviewing a district court's determination of adequacy of representation issues under Rule 23.1. *Owen v. Modern Diversified Industries, Inc.*, 643 F.2d 441, 443 (6th Cir. 1981); *Hornreich v. Plant Industries, Inc.*, 535 F.2d 550, 552 (9th Cir. 1976); *Lewis v. Curtis, supra*, 671

F.2d at 789; *Rothenberg v. Security Management Co., Inc.*, 667 F.2d 958, 960, 963 (11th Cir. 1982).

The abuse of discretion test has two distinct components – factual and legal. Which component applies depends on the nature of the appellant's contention. Thus, if the appellant claims that the district court erroneously resolved *factual* questions, the reviewing court will reverse if the district court's factual findings are "clearly erroneous" – *i.e.*, when " 'the reviewing court on the entire evidence is "left with the definite and firm conviction that a mistake has been committed." ' " *Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985), *quoting*, *United States v. United States Gypsum Co.*, 333 U.S. 364, 395 (1948); *accord*, *Dollar Rent A Car of Washington v. Travelers Indem.*, 774 F.2d 1371, 1374 (9th Cir. 1985); *Edinburgh Assur. Co. v. R.L. Burns Corp.*, 669 F.2d 1259, 1261 (9th Cir. 1982); *Owen v. Modern Diversified Industries, Inc.*, *supra*, 643 F.2d at 443[11]

Where a pure *legal* question is involved, however, the abuse of discretion test mandates reversal where the lower court's order was based on or influenced by an erroneous legal premise. *FSLIC v. Sahni*, 868 F.2d 1096,

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[11] Thus, in *Matter of Beverly Hills Bancorp*, 649 F.2d 1329, 1333-1334 (9th Cir. 1981), this Court held that the district court had erred in reforming a contract on the basis of mutual mistake, because neither party had requested reformation or revision, but instead had merely sought interpretation of the contract as written. Because there was nothing in the record to support the conclusion that the contract between the parties failed to express their mutual intention, the Court of Appeals was left with a " 'definite and firm conviction that a mistake had been committed.' " *Id.* at 1334.

1097 (9th Cir. 1989); *Heat and Control, Inc. v. Hester Industries, Inc.*, 785 F.2d 1017, 1022 (Fed. Cir. 1986) (and cases cited). Stated differently, "[a] district court's order is reversible for legal error if, in applying the appropriate standards, the court misapprehends the law with respect to the underlying issues in the litigation. [Citation.]" *Dollar Rent A Car of Washington v. Travelers Indem., supra,* 774 F.2d at 13. An abuse of discretion will be found where, in light of the "relevant factors," there was a "clear error in judgment. . . . " *Id.; accord, Kern v. TXO Production Corp.*, 738 F.2d 968, 970 (8th Cir. 1984) "[abuse of discretion] means . . . that the court has a range of choice, and that its decision will not be disturbed as long as it stays within that range and is not influenced by any mistake of law"). In such cases, the legal issues are reviewed *de novo* by the reviewing court. *FSLIC v. Sahni, supra,* 868 F.2d at 1097.[12]

The Court of Appeals based its reversal in part on this second component of the abuse of discretion test. The Court held that the district court erred as a matter of law

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[12] Thus, in *Lewis v. Curtis, supra,* 671 F.2d 779, the Court of Appeals reversed the district court's finding of inadequate representation, holding that it had erred as a matter of law – and consequently had abused its discretion – in disqualifying the plaintiff because he owned only 100 of the corporation's 8 million shares. The Court found "no basis for dismissing [the plaintiff's] complaint simply because he only owns a few shares of . . . stock." *Id.* at 788. The Court also rejected the directors' claim, again as a matter of law, that the plaintiff's ignorance as to the facts concerning the challenged transactions renders the plaintiff an inadequate representative, stating: "[w]e do not believe that [familiarity with the facts] makes vigorous representation of the class any more likely." *Id.* at 789.

when it required Mr. Larson to be a member of a "class" of minority shareholders, whose views concerning the action were determinative of the standing question. This holding is obvious from the Court of Appeal's conclusion that Mr. Larson was not similarly situated to the other shareholders because each of them is "presently or have been employees of Round Table" and each "has an economic interest in supporting the current management: the Dumke group." (A-26)

Once again, Round Table does not mention this aspect of the Court of Appeals' opinion. Yet, it is an independent basis for reversal, and does not depend on the outcome of the ESOP rescission and/or strike suit issues. Most importantly, because it represents a correct application of the legal component of the abuse of discretion test, it creates no inter-circuit conflict for this Court to resolve, and certiorari is inappropriate.

Even on the ESOP rescission and strike suit issues, to which the Court of Appeals applied the factual component of the abuse of discretion test, the Court did not err in concluding "on the entire evidence" that " 'a mistake [had] been committed.' " *Dollar Rent A Car of Washington v. Travelers Indem., supra,* 774 F.2d at 1374. On the ESOP rescission issue, as the record and oral argument confirmed, Mr. Larson did not make a "meaningful" (A-22) demand – "formally" (A-7) or otherwise – to rescind the ESOP, nor did the district court ever permit him to seek a rescissionary remedy. Rescission was not pled in either the original or the first amended complaint (CR 1, 149), and none of Mr. Larson's fellow minority shareholders

were ever joined as defendants. (A-22)[13] Thus, while Mr. Larson's trial counsel discussed rescission in opposing Round Table's motion to dismiss, and Mr. Larson at one point did withdraw his "offer" *not* to seek rescission (when all of the remaining shareholders failed to abandon their opposition to the lawsuit) (CR 319 at ¶ 9), the Court of Appeals could properly conclude that this discussion was irrelevant because rescission had never been properly sought in the first place.[14] The district court's conclusion to the contrary was therefore "clearly erroneous" and the Court of Appeals' reversal for abuse of discretion was correct.

The Court of Appeals also properly reversed for abuse of discretion on the "strike suit" issue. The district court had before it two explanations for Mr. Larson's offer to sell stock to Round Table at higher-than-ESOP prices: (1) Mr. Larson's detailed explanation – accompanied by documentary evidence – that his offer was an attempt to free his shares from Round Table's right-of-first-refusal requirement and to ensure the transferability of those shares to buyers other than Dumke group members (CR 257 at 2, CR 319 at 1-4, CR 320, Exh. B, CR 321, Exh. A, CR 330 at 16, n. 12); and (2) the declaration from

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[13] The district court denied Mr. Larson's motion to amend his complaint to add those shareholders as defendants so that the court would be in a position to permit rescission – a motion made between the district court's first and second orders – as an exercise in futility because the derivative claims had been dismissed. (A-47-49)

[14] Mr. Larson was represented in the district court by the firm of Brobeck, Phleger & Harrison. On appeal, present counsel substituted in.

Thomas Toldrian, Round Table's Chief Financial Officer and a director at the time of the alleged misconduct [*see*, A-26], who stated that Mr. Larson told him "that his motivation in bringing this action is to achieve the sale of his own Round Table stock at a premium price" (CR 232 at 4).

Mr. Larson steadfastly denied that the lawsuit was a ploy to achieve a higher price for his shares. (CR 257 at 2, CR 319 at 4) Nevertheless, in its first order, the district court found that "economic antagonism" existed between Mr. Larson and the other shareholders because of, *inter alia*, "the higher price plaintiff has attempted to obtain for his stock." (CR 291 at 3, (A-36)) However, *after* Mr. Larson offered his explanation for the stock sale proposal, the district court on reconsideration apparently abandoned that ground as a basis for finding that Mr. Larson was an inadequate representative. (*Compare*, CR 291 at 3 (A-36) *with* CR 344 at 4-5 (A-46))

It was in this posture that the issue was presented to the Court of Appeals. That Court found that Mr. Larson's version of the facts was "consistent with communications with Round Table management at the time of the offering." (A-28) Indeed, in the district court Round Table had attacked Mr. Larson's explanation as "nonsensical" (CR 338 at 9), but it *never* denied that the steps he took *would* free up his shares for sale to others.[15] In light of the

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[15] In any event, the notion that Mr. Larson could legally sell his shares to Round Table at a higher price or on terms not available to every other shareholder is erroneous. *See, Jones v. H.F. Ahmanson & Co.*, 1 Cal.3d 93, 108-111 (1969). Since Mr.

(Continued on following page)

timing of the stock sale offer (after the right-of-first-refusal requirement was instituted), the district court's abandonment of the "strike suit" ground in its second order, Mr. Toldrian's status as a potential wrongdoer, and the documentary evidence Mr. Larson offered as compared to the hearsay statement Mr. Toldrian attributed to him, the Court of Appeals was entitled to reject the district court's earlier "strike suit" finding as mistaken and to permit Mr. Larson to proceed with the merits of his action. *Matter of Beverly Hills Bancorp, supra,* 649 F.2d at 1334.

2. The Court of Appeals' Decision Was Not A "Departure," Much Less A "Far Departure" From Accepted Judicial Decisions

Finally, Round Table claims that certiorari is mandated because the Court of Appeals decision represents a "far departure" from accepted judicial decisions. (Petn. at 27-28, Supreme Ct. Rule 10.1(a) It bases this claim on the Court of Appeal's analysis of the ESOP rescission issue and that Court's failure to rectify the error by a grant of rehearing. (*Id.* at 28-30) As noted above, the Court properly analyzed the ESOP rescission issue and reached the

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Larson was closely and continuously counselled by his lawyers, pressing the derivative lawsuit to obtain an illegal result would have meant that his lawyers were in essence attempting to engage in unlawful conduct. The Court of Appeals' resolution of the issue demonstrates that even it was unwilling to indulge in this reasoning. This is a further reason why Mr. Larson's explanation for the stock sale offer was the only credible version.

correct result based on the pleadings and the district court's denial of the motion to amend. Any suggestion that the Court of Appeals departed (a little or a lot) from the "accepted and usual course" of judicial proceedings is without merit.[16]

CONCLUSION

The Court of Appeals reviewed the district court's ruling through the appropriate abuse of discretion lens of appellate review and correctly concluded that that court's view of Rule 23.1 – that opposition by the non-defendant shareholders necessarily renders a derivative plaintiff an inadequate derivative representative – was flawed as a matter of law. The court properly applied the factors the Sixth Circuit articulated in *Davis v. Comed*, found that the other non-defendant shareholders were not "similarly situated" to Mr. Larson and held that he was therefore an adequate derivative representative. This was not even a "departure" (much less a "far departure") from existing precedent, represented a correct application of the "abuse of discretion" standard of review, and was consistent with other decisions under the adequacy of representation element of Rule 23.1. There is nothing novel or

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[16] It is not surprising that Round Table cites no authority for its claim that the Court of Appeals acted improperly by "conducting its own 'painstaking study of the trial record' " on an issue not raised by the parties. (Petn. at 29) Of course, as section IV.B. of its opinion demonstrates, the Court *also* based its opinion on the "single shareholder" argument that Mr. Larson urged.

important, let alone erroneous, about the Ninth Circuit's opinion, and certainly no reason why this Court should intervene. Accordingly, the petition should be denied.

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Respectfully submitted,

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